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Deregulation

Public Law 96-221—the Depository Institutions Deregulation and Monetary Control Act—has been on the books for only four months' time, but it is already living up to its billing as the most far-reaching piece of financial legislation of the past generation. Controversy has developed around several sections of the legislation. However, most of the arguments to date have centered around Title II (Depository Institutions Deregulation), which established mechanisms for phasing-out deposit interest-rate ceilings within a six-year period.

In moving toward deregulation, Congress asserted that statutory limitations on savings interest rates actually discouraged savings, created inequities for depositors, and hindered depository institutions in competing for funds—and also failed to achieve their intended purpose of providing an even flow of funds for home financing. Congress thus set up a Deregulation Committee to achieve its mandate, with a membership consisting of the Secretary of the Treasury and the Chairmen of the Federal Reserve Board of Governors, the Federal Deposit Insurance Corporation, the Federal Home Loan Bank Board and the National Credit Union Administration, along with the (non-voting) Comptroller of the Currency.

Congress specifically instructed the Committee to provide savers with a market rate of return by increasing all rate ceilings "as soon as feasible," with "due regard for the safety and soundness of depository institutions." The Committee's powers are limited in several ways. During the phase-out period, it can't eliminate the quarter-percentage-point differential which thrift institutions can pay over commercial-bank rates on passbook savings and other categories of time and savings accounts authorized as of December 1975. (Thus, that restriction does not apply to the money-market and small-saver certificates developed during the past several years.) Again, the legislation does not even address the most formidable rate ceiling—the outright prohibition of interest payments on *demand* deposits. But on balance, Congress clearly intended to eliminate rate ceilings on *time* deposits after a six-year period.

Critical decisions

The Deregulation Committee's initial actions this spring were welcomed by most bankers and household savers, but generally criticized by thrift institutions and home builders. One committee proposal, not yet implemented, would prohibit depository institutions from offering premiums or gifts ("freebies") to depositors opening new accounts or adding to existing ones. Critics have argued that this proposal would involve more, rather than less, regulation, and that it would deprive institutions of a useful marketing tool. Defenders of this move, on the other hand, have argued that it would be consistent with the planned phase-out of ceilings on the payment of explicit interest, and with the general movement toward the use of explicit prices rather than implicit prices (with premiums) for financial services.

In another action designed to help depository institutions compete more effectively for deposits, the committee moved to liberalize rate ceilings on the popular money-market and small-saver certificates. (The rate on MMC's is tied to the six-month Treasury-bill auction yield, while the rate on small-saver certificates is tied to the thirty-month Treasury-note yield.) Among other rulings, the committee narrowed the range in which thrifts may pay the full quarter-percent differential to the 7.5-8.5 percent spectrum of bill rates, and allowed commercial banks a one-time "rollover" bonus on maturing MMC's at the thrifts' ceiling rate. Thrift institutions argued strongly against these rulings; in fact, the U.S. League of Savings Associations filed suit to void the committee's actions, partly on the grounds that only one of the committee members "has a primary statutory duty to provide for sound and economical home financing."

Much of the controversy centers around the thrift institutions' fear that their loss of the quarter-point differential on rate ceilings would reduce the flow of funds into mortgage finance—including perhaps a $17-billion loss this year because of the banks' ability to offer the rollover bonus on maturing MMC's. But the banks respond that they too would channel new flows of funds into housing; in the San Francisco Reserve District, for example, weekly reporting banks hold a larger proportion of their loan portfolios in real-estate than in business loans ($47 billion vs. $33 billion).

Major issues

The response to arguments such as these may well influence the pace at which deposit interest-rate ceilings are phased out, or perhaps decide whether they will ever be completely eliminated. One major question centers on the role of housing in the economy and the extent to which it should be afforded priority treatment. A related issue is the viability of the thrifts and their ability to operate in an environment without rate ceilings. In the new legislation, Congress required each member of the Deregulation Committee to prepare an annual report specifically addressing these questions. Each report is to include recommendations designed to assure a steady flow of funds into the housing sector, and to assess the impact of uninsured money-market innovators (such as money-market mutual funds) in reducing the flows of funds into insured banks and thrift institutions.

The deregulation game plan, as laid out in the basic legislation, contains several mechanisms for helping thrifts adjust to the new environment, including provisions for substantially broadening their third-party payment and lending authority. To the same end, the legislation authorizes a Federal override of state usury ceilings on mortgage rates, although states could forestall that move by imposing new ceilings within four years of passage of the act. Meanwhile, over consumer-group opposition, the Federal Home Loan Bank Board has authorized member institutions to offer renegotiable mortgages, resembling the Canadian-type "rollover" mortgage—reflecting Chairman Jay Janis' view that "thrifts cannot pay savers a market rate of return" unless they can obtain a market rate of return on their loans.

In recent weeks, the Bank Board has proposed several specific steps that would broaden thrift-institution powers under the new law—and in the process, assist first-time home buyers. The regulations would raise the basic S&L home loan from 80 percent of value to 90 percent, raise the maximum home loan from $75,000 to $200,000, and extend the maximum term from 30 to 40 years. In addition, they would permit S&L's to allocate as much as 20 percent of their assets to consumer loans, and would permit them to broaden their sources of funds by borrowing up to 50 percent of total assets—including, within that overall constraint, the elimination of previous limits on borrowings through commercial paper, mortgage-backed bonds, reverse repurchase agreements, and commercial-bank loans. The Bank Board also has authorized S&L's to issue credit cards and to offer interest-bearing check-type accounts (NOW accounts) beginning in 1981.

Other solutions

Many observers would contend, however, that the best cure for the problems of housing would be to wring inflation out of the economy. As Federal Reserve Chairman Volcker recently told the National Association of Mutual Savings Banks, a close relationship exists between Switzerland's 4½-5 percent mortgage money and that country's low rates of money growth and inflation. In any case, wringing inflation out of the economy could defuse much of the opposition to compensatory devices such as the renegotiable mortgage, and conceivably obviate the need for them.

Housing also would benefit from the implementation of the recommendations of many study groups over the years—especially the Hunt Commission of 1971. That commission argued for the phase-out of deposit interest-rate ceilings, and also advanced other proposals which may be worthy of consideration—including the possible use of tax credits for investors in residential mortgages, and a system of mortgage interest-rate insurance to reimburse lenders when market rates rise by a certain amount above yields on existing portfolios. But the commission also had strong views about the proper approach to take if "a properly functioning intermediary system left housing goals unmet." In that event, it said, home buyers and renters should be subsidized directly through the Federal budget, where costs and benefits are clearly measurable, rather than through a welter of differential portfolio and price constraints that are riddled with subsidies and taxes of uncertain incidence, and which tend to "warp" financial institutions and credit markets.

Beyond that, there is the basic question of where housing and home finance stand among the nation's lengthy list of priorities. Most analysts would concede that the fight against inflation requires a higher level of saving and investment, and an attendant increase in badly lagging productivity. Also, they would agree that eliminating deposit rate ceilings *a priori* should increase the flow of savings into depository institutions, but they might disagree about where those savings should go. Housing clearly ranks very high on the list of the nation's social needs, but it adds nothing directly to the nation's industrial capacity, which is so necessary for making the nation more productive.

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BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT
(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 7/23/80	Change from 7/16/80	Change from year ago Dollar	Percent
Loans (gross, adjusted) and investments*	136,931	– 9	7,524	5.8
Loans (gross, adjusted) — total#	115,261	– 33	8,453	7.9
Commercial and industrial	33,244	40	1,842	5.9
Real estate	46,803	137	7,664	19.6
Loans to individuals	23,548	– 36	1,003	4.4
Securities loans	985	12	– 851	– 46.4
U.S. Treasury securities*	6,290	16	– 1,246	– 16.5
Other securities*	15,380	8	317	2.1
Demand deposits — total#	42,371	–1,790	382	0.9
Demand deposits — adjusted	31,027	– 921	185	0.6
Savings deposits — total	28,870	151	– 1,816	– 5.9
Time deposits — total#	61,745	211	10,869	21.4
Individuals, part. & corp.	53,463	201	11,253	26.7
(Large negotiable CD's)	22,285	169	4,364	24.4

Weekly Averages of Daily Figures	Week ended 7/23/80	Week ended 7/16/80	Comparable year-ago period
Member Bank Reserve Position			
Excess Reserves (+)/Deficiency (–)	– 50	– 65	27
Borrowings	30	47	232
Net free reserves (+)/Net borrowed(–)	– 80	– 112	– 205

* Excludes trading account securities.
\# Includes items not shown separately.

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